Germany: Confusion as a sign of stabilisation

Diverging signals from the main leading indicators in Germany underline the ongoing dichotomy between services and manufacturing but in our view are also a sign of stabilisation

Source: istock

Germany's most prominent leading indicator, the Ifo index, dropped to 99.2 in April, from 99.7 in March. Both the current assessment and the expectations components dropped. The (temporary) Brexit relief, the gradual weakening of the trade-weighted exchange rate as well as positive macro news from China and tentative signs of improvement in global trade were not enough to boost German companies' optimism.

In fact, the sector components confirm the ongoing dichotomy in the German economy. While confidence in the services and construction sectors improved, it continued its downward trend in the manufacturing sector. This decoupling of services and the manufacturing sector, however, is not a new phenomenon. It already started in 2015. Since then, the manufacturing sector has gone through a full cycle, while the service sector remained constantly stable. Another interesting aspect of the current downswing of the German economy is the fact that downturns normally follow on prior excesses. The German economy, however, did not show any excesses that would require a cleansing correction. Consequently, the economy is currently witnessing the slowdown which basically came from nowhere.

At first glance, today's drop in the Ifo index seems to dent any optimism for German growth. At second glance, however, the picture is much more complex. Over the last weeks and months, there has been a zigzagging of the main confidence indicators. In our view, a sign of stabilisation of the economy; nothing less and nothing more. In this regards, don't forget that the current situation in the industry is not as disastrous as some previous data points suggested. Order books are still filled, and according to surveys, production is assured almost as long as last summer. Still, the risk of a negative sentiment loop or a cycle of fear has not ebbed away, yet.

Looking ahead, the reversal of last year's one-off factors, some encouraging recent evidence from global activity as well as continued solid domestic fundamentals are in our view still strong arguments in favour of a brightening outlook for the German economy. In fact, in the light of many rather pessimistic headlines on the German economy, the first quarter might actually surprise to the upside. Judging from all available data so far, retail sales, car sales, employment, exports and construction were all stronger than in 4Q18.

As much as we would have liked to see a stronger Ifo index today, the recent set of German sentiment indicators shows two things: 1) the manufacturing sector is not out of the woods, yet and the zigzagging should be seen as evidence of a bottoming out. Confusion as a sign of stabilisation.

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